

Internal Revenue Service
Appeals Office
4330 Watt Avenue SA 7890
Sacramento CA 95821-7012

Release Number: 201704018
Release Date: 1/27/2017
Date: November 3, 2016

Department of the Treasury

Employer Identification Number:

Person to Contact:

Name
Employee ID Number:
Tel:
Fax:

UIL: 501.03-05

Certified Mail

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code.

Our determination was made for the following reason(s):

You are not an organization described in section 501(c)(3) of the Code because you are not organized and operated exclusively for charitable or educational purposes. In addition you are not as described in Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations because you fail both the organizational and operational tests. Your articles provide that your specific purpose is to provide affordable health care through education and institute voluntary employee beneficiary association (VEBA) participation. Because establishing participation in VEBA is not an enumerated exempt purpose under Section 501(c)(3), you are not organized exclusively for purposes described in the regulations. Because establishing participation in a VEBA is not an enumerated exempt purpose under Section 501(c)(3), you are not operated exclusively for an exempt purpose.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Form 1120. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of the adverse determination, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

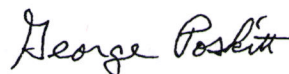
We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

A handwritten signature in cursive script that reads "George Poskitt".

George Poskitt
Appeals Team Manager

Enclosure: Publication 892 and/or 556

Internal Revenue Service

Appeals Office SA 7890

4330 Watt Avenue

Sacramento CA 95821-7012

Date: **NOV - 8 2016****Department of the Treasury****Employer Identification Number:****Person to Contact:**

Name

Employee ID Number:

Tel:

Fax:

Certified Mail

Dear

We considered your appeal of the adverse action proposed by the Director, Exempt Organizations, Rulings and Agreements. This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in section 501(c) (9) of the Code.

Our adverse determination was made for the following reason(s):

You are not an organization described in Section 501(c) (9) of the Code and Sections 1.501(c) (9)-1, 1.501(c) (9)-2(a) (1) or 1.501(c) (9)-2(a) (2) of the Regulations, because you are not an association of employees whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Employees of any business in the United States that are smart card carrying members are not defined by reference to a common employer, affiliated employers, coverage under a collective bargaining agreement, or membership in a labor union. Additionally, there is no evidence that the eligible employers are engaged in the same line of business in the same geographic locale.

You are required to file Federal income tax returns on Forms 1120. File your returns with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

United States Tax Court
400 Second Street, N.W.
Washington, D.C. 20217

U.S. Court of Federal Claims
717 Madison Place, N.W.
Washington, D.C. 20439

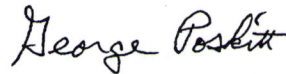
U.S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, D.C. 20001

Processing of income tax returns and assessments of any taxes due will not be delayed if you file a petition for declaratory judgment under section 7428 of the Internal Revenue Code.

You may also be eligible for help from the Taxpayer Advocate Service (TAS). TAS is an independent organization within the IRS that can help protect your taxpayer rights. TAS can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 1-877-777-4778.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,



George Poskitt
Appeals Team Manager

Enclosure: Publication 892



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Date: August 3, 2016

Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

N= State

O=Date

P= Name

Q= Name

R= Name of LLC

S= Geographical Area

T= Card Name

U= City

V=Name

x dollars= Dollar amount

UIL:

501.03-30

501.09-04

This letter supersedes our letter dated May 12, 2015

Dear Applicant:

We considered your applications for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Sections 501(c)(3) and 501(c)(9) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issues

- Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons explained below.
- Are you an association of employees which qualifies for exemption from tax under the provisions of section 501(c)(9)? You are not for the reasons stated below.

Facts

You were incorporated in the state of N on O as a nonprofit corporation. Your stated purposes are to "provide affordable health care through education and institute VEBA participation".

You applied for recognition of exemption from federal income tax under both Sections 501(c)(3) and 501(c)(9) of the Internal Revenue Code. Both Application Forms 1023 and 1024 were filed with the Internal Revenue Service on the same date. You are a membership organization and have two classes of membership. Both the Form 1023 and the 1024 included an identical narrative description of the programs available to members as listed below:

- Access to an on-line counselor to assist with the healthcare decision process.
- Access to healthcare buying group for commodity medicine like lab work, Rx, devices that demonstrate healthy individual, and durable medical equipment.
- Access to a specialist via your website who will negotiate the cost of healthcare service before a service is rendered.
- Access to an online application that allows the participant to have a fair market estimate of costs for both current and future healthcare services.
- Access to an online healthcare savings calculator. "Planner".
- Referrals to a P consultant for assistance in relationship management and personalized wellness.
- Access to have questions answered as well as access to supply online links for better understanding of your member's requirements under the Patient Protection and Affordable Care Act.
- Access via your website the ability to observe animals in their natural environment ("animal therapy").
- Access to a "library of healthcare information" via website links to various health related articles, videos, studies and other publications.
- The opportunity to voluntarily enroll in a 501(c)(9) trust.

Schedule F to your 1024 Application also reports each of your members "have the choice to enroll in the 501(c)(9) trust." "Should they choose to enroll they will have a Q account trust for benefits funded by a fully insured policy." "Each individual trust will vary with regards to the benefits they have."

Participants are issued a Q card (described as a smart card). This card is used when receiving healthcare services. All claims are sent to the participants Q account trust and then forwarded to the carrier for adjudication. All covered items within the Q account trust are paid by the trust. This gathered history becomes a personal electronic health record for the participant. All claims are matched with corresponding explanation of benefits (EOBs) for accuracy. Claims not processed correctly will be appealed. These services are administered for you by R.

You have two levels of membership. Class 1 Membership consists of members who enroll into the 501(c)(9) trust and are given voting rights via membership while Class 2 Membership are those whom utilize all services other than the 501(c)(9) trust and do not have membership voting rights.

Your Articles of Incorporation and Bylaws do not include provisions for membership. The Articles say you are organized on a nonstock basis and on a "Directorship" basis. Your bylaws explain you are managed by a Board of three Directors who are elected once each calendar year at the annual meeting of the board. In response to additional information regarding membership qualification you submitted a membership program agreement. The membership agreement authorizes you to collect payments for memberships in exchange for access to the following programs:

- Healthcare Buying Group
- Electronic Health Record including utilization cost history

- Medical Service Provider Negotiation – Your Advocate
- Insurance Company Audit including medical/dental claim reprocessing and appeals process
- Medical, Dental, Rx cost estimator
- Healthcare Savings Calculator-Planner
- Relationship Enhancement – P method
- Participation in VEBA Trust
- Help with the PPACA
- Animal Therapy – On site and via the website.
- Library of Healthcare information
- Online counselor to assist with healthcare decision process.

For those members who participate in the VEBA an additional monthly administration fee is charged. “When enrolled in this program you will be issued a Class 1 membership Certificate giving you voting rights for operation of the VEBA Trust.”

Schedule F also reports there are two employees covered by the VEBA. Additional information you provided explained that these two employees are employed by two small employers who agreed to sign contracts to participate when you are granted exempt status. The two employers both have fully insured health policies. The common bond with these two is “they are both employers within the United States, both are participants (in your organization) and employees of both will carry Q card.”

The financial information on page nine of the 1023 and on page five of the 1024 report identical revenues and expenses. These proposed budgets show your anticipated revenues are from gross dues and assessments of members. An attached schedule reports your total revenues are subdivided into annual membership fees and revenues from VEBA participants. VEBA revenues represent approximately eighty percent (80%) of your total revenues. More than forty percent (40%) of your total expenses are monthly payments to R.

Your proposed budgets also reported monthly royalty payments to Q groups. You explained that there are two Q groups. Q groups “are a grass roots marketing strategy for health systems and employers.” “For all business they acquire they are paid a royalty.” One of the two Q groups receiving royalties is owned by one of the small employers identified on Schedule F.

You are also the Trustee of a VEBA Trust Agreement. The purpose of the VEBA Trust is to provide “a mechanism pursuant to which certain employers located in S can obtain health, life, dental and/or vision coverage through a defined contribution structure on an individual fully-insured basis for their employees.”

An employer establishes an ERISA (Employee Retirement Income Security Act) group qualified health plan trust and enrolls in your VEBA trust. The employer then establishes a Q account for each employee participant. Under the terms of the VEBA Trust you as Trustee establish within the Trust Fund separate “sub-accounts” for each Plan (members Q account) sponsored and maintained by an employer. “The Trust Fund shall be funded with Employer Contributions or Member Contributions.” “Causes for payment from the employee participant’s Q account will be insurance premiums due and eligible expenses.”

Provisions within the VEBA Trust Agreement restrict the type of Plans that may be funded through the Trust. “To facilitate the process of approving Plans for inclusion in the Trust, The Trustee may (a) identify one or more fully insured health, life, dental and/or vision plans that will be offered to Employers who are interested in

participating in the Trust; (b) design one or more self-insured health, life, dental and/or vision plans that will be offered to Employers who are interested in participating in this Trust; and (c) pre-approve one or more third party administrators, stop-loss insurance or re-insurance companies and/or other ancillary vendors for use by Employers whose Plans are funded through this Trust.”

“Each employer shall make contributions to the Trust Fund in such amounts and at such times as it shall determine or as requested by the Trustee.” “Each Employer’s Contributions shall be based on the amounts necessary to provide for the benefits expected to become payable, to pay any premiums or eligible expenses becoming due for the individual member’s Q account.” “Members and former members may make contributions to the Trust Fund if, and to the extent, allowed under the terms of a Plan.”

You as the Trustee “shall have exclusive authority and discretion to manage and control the Trust Fund, and the rights, powers and duties of the Trustee shall be governed by the terms and conditions of the Trust Agreement.” To assist in the administration of the “Plans” you have entered into a management agreement with R. “R will administer the placement of the defined contribution from the participating employer into the employee participant’s VEBA Q account.” R will collect provider claims and all insurance policies’ explanation of benefits as a base line. R will then adjudicate eligible expenses from the participant’s Q account.

According to the terms of the management agreement R will enroll eligible employees into the plans and provide certain health cost management services with respect to your participants. These services include:

- Education of the health services covered under the Plan.
- Education of the benefits under the Plan.
- Education of the unusual and customary charges for a given procedure.
- Education of procedures requiring pre-certification.
- Education of options available for treatment of health problems and possible out-of-pocket expense.
- Answer questions about eligibility for benefits under the Plan.
- Answer questions or concerns regarding the Plan to provide ongoing communication with the participants, to increase understanding of the benefits and any treatment recommended by a health care provider.
- Analysis and clinical review of claims by an R.N. to check for up coding, medical appropriateness, double billing and concurrent care.
- A case management filtering system for identification of probable high cost users of the plan for referral to continuous case management to promote provision of quality services and to control health care costs.
- Implementation and maintenance of the mail order prescription drug program, which shall include maintenance of eligibility for prescription claims;
- Assistance in negotiating the agreement with the pharmaceutical vendor engaged to provide prescription drugs;
- Administration and record keeping of prescription requests; and
- Communication between vendor and participant regarding prescription drug issues and claim processing of mail order claims.
- With notification to you, conduct a pre-audit screening of hospital bills to verify that such bills are correct, report the results of such screening to you and if requested conduct a full hospital bill audit.
- R will process all claims submitted by participants.

R will also provide or arrange to provide for you the development and design of the Plan, initially and in connection with benefit revisions, additions and extension. This shall include, but is not limited to:

- Assistance in obtaining general underwriting and actuarial advice, if necessary,
- Assistance in the preparation of descriptions for the benefit programs under the Plan, and
- Eligibility and benefits schedules for claims management.
- Development, design and installation of administrative and record keeping systems.

According to the agreement with R you will pay R a one-time installation fee of 50% per enrollee. The fee schedule also includes monthly health cost management fees of 50% per contract. Management fees may increase on an annual basis. R will notify you of an increase in fees at least sixty days prior to the date the increase becomes effective.

In addition to the management agreement you also have an agreement with R for the non-exclusive right to use the trademark "Q card". R owns the trademark "Q card" and all goodwill in connection with the marketing and provision of certain health cost management services.

You explained that "R was selected for their smart card application and unique software integration through the smart card." "No other firms that were reviewed offered a product like Q card that is one of the common bonds that employer clients share."

You acknowledged that another company had acquired the rights to use Q card from R. The owner of this company was related by marriage to one of your board members. You clarified that T had been dissolved because the market had changed and they could no longer compete.

In response to additional questions regarding the eligibility of the VEBA program you stated:

Participation in your VEBA is voluntary. You contract with the employer to structure a defined contribution benefit plan. Although you plan to contract with employers within the United States you are willing to limit membership to geographic proximity. The employees have free choice of where to buy their health insurance and other forms of approved insurance. Members who enroll in the VEBA program are issued a membership certificate which gives them voting rights on the management of the VEBA trust. You will not have control of the members' money. "Only with their written direction will funds be dispersed."

All who apply for enrollment are accepted. All employees are given the opportunity to voluntarily participate. Employees that choose to become members are issued a Q card. You said this structure creates a common bond.

You also explained that R is contracted by you to monitor membership metrics and ensure 90 percent of the total membership is comprised of employees.

Your board "has no financial interest in Q card or R." You explained that you are not in the commercial insurance business and will not market as such.

Law

- Issue One: §501(c)(3)

Section 501(c)(3) of the Code provides, in relevant part, exemption from federal income tax for corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable,

scientific, literary, or educational purposes, no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations ("regulations") provides that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes; and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations explains that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, (1945) the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In construing the meaning of the phrase "exclusively for educational purposes" in Better Business Bureau of Washington, D.C., Inc. v. U.S., 326 U.S. 279 (1945), the Supreme Court of the United States said, "This plainly means that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes." This rationale applies equally to any category of exempt purpose under section 501(c)(3) of the Code. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried on by a university.

In Harding Hospital, Inc. v. United States, 505 F.2d 1068 (1974), the court held that an organization seeking a ruling as to recognition of its exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In the court case est. of Hawaii v. Commissioner, 71 T.C. 1067(1979), an organization, which was formed for educational purposes, accomplished its educational activities pursuant to licensing agreements with for-profit corporations that amounted to significant control over the functioning of the non-profit organization, did not qualify for exemption from income tax under Section 501(c)(3). Neither the fact that the for-profit entities lacked structural control over the organization nor the fact that that amounts paid to the for-profit organizations under contracts were reasonable had affected the court's conclusion that organization did not qualify as an organization exempt under Section 501(c)(3).

In Easter House v. United States, 12 Cl. Ct. 476 (1987), aff'd, 846 F.2d 78 (Fed. Cir. 1988) cert. denied, 488 U.S. 907, 109 S. Ct. 257, 102 L. Ed. 2d 246 (1988), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt commercial purpose. The court concluded that its primary activity was placing children for

adoption in a manner indistinguishable from that of a commercial adoption agency. The court found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in section 501(c)(3).

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for an exempt purpose. The court stated that among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g., advertising) and the extent to which the organization receives charitable donations.

- Issue Two: §501(c)(9)

Section 501 (c)(9) of the Code provides for the exemption from federal income tax of voluntary employee's beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-1 of the regulations provides that an organization described in § 501(c)(9) must be (a) an association of employees; (b) an association whose membership must be voluntary; (c) an association whose purpose is to provide for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits, and (d) an association whose net earnings does not inure, other than by payment of the benefits referred to in (c), to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-2(a)(1) of the regulations provides that the membership of an organization described in section 501(c)(9) of the Code must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment related common bond.

Section 1.501(c)(9)-2(a)(2) provides that eligibility for membership may be restricted by geographic proximity, or by objective conditions or limitations reasonably related to employment, such as a limitation to a reasonable classification of workers, a limitation based on a reasonable minimum period of service, a limitation based on maximum compensation, or a requirement that a member be employed on a full-time basis.

Application of Law

Issue One: §501(c)(3)

You are not as described in section 501(c)(3) of the Code because you are not exclusively organized and operated for charitable or educational purposes.

You are not as described in Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations because you fail both the organizational and operational tests.

You are not organized exclusively for one or more exempt purposes, as described in 501(c)(3)-1 (b)(1)(i) of the Income Tax Regulations. Your articles provide that your specific purpose is to provide affordable health care through education and institute VEBA participation. Because establishing participation in VEBA's is not an enumerated exempt purpose under Section 501(c)(3), you are not organized exclusively for purposes described in the regulations.

You do not meet the provisions of Section 1.501(c)(3)-1(c)(1) of the Regulations because more than an insubstantial part of your activities is not in furtherance of an exempt purpose; this is illustrated by the fact that you are managing a trust that enables employers to establish separate VEBA sub-accounts for their employees. The trust is funded by employer and employee contributions. Payments from these sub-accounts pay for the employee participant's insurance premiums. This shows you are operating for substantial non-exempt private purposes.

Furthermore, you do not meet the provisions in Section 1.501(c)(3)-1(c)(1) of the Regulations because you are operating in a commercial manner ; this is demonstrated in the types of services being provided to your members. For example, members' health care claims are processed by you and you are operating a mail order prescription program. These services to your participants are commercial like in nature and also demonstrate you are operating for substantial nonexempt purposes.

You are not as defined in Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations, because you serve private rather than public interests. This is indicated by the comprehensive contract you have with R who has exclusive responsibility to provide services to your members and the fact R is receiving over 40% of your revenues as well as by your agreement with R for the non-exclusive right to use the trademark Q card. You are also operating for the private interests of your members and the employers who participate in the VEBA by your management of the VEBA.

Your structure is very similar to that described in Est. of Hawaii v. Commissioner, 71 T.C. 1067(1979). Like this organization you have a comprehensive contract with a for profit (R); the terms of the contract show you have ceded control of your operations to R. If you wanted to remove yourself from R, you would not be able to function. As in est. of Hawaii, you are totally dependent on one for profit for your operations which disqualifies you from tax exemption.

You are like the organization described in Arlie Foundation, *supra*, you carry out a number of charitable and educational activities that are incidental to your nonexempt commercial activities including assisting in the development and design of healthcare plans, processing health care claims and operating a mail order prescription drug program. You are in competition with other for profit entities and your services are not provided below cost which precludes you from exemption under Section 501(c)(3).

Similar to the organization in Better Business Bureau of Washington, *supra*, although you may have some charitable and educational activities, you are not "operated exclusively" for exempt purposes. Like the organization in this court case Easter House, *supra*, a single nonexempt purpose destroys your claim for exemption.

Issue Two: §501(c)(9)

You are not as defined in Section 501(c)(9) of the Code and Sections 1.501(c)(9)-1, 1.501(c)(9)-2(a)(1) or 1.501(c)(9)-2(a)(2) of the Regulations, because you are not an association of employees whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Employees of any business in the United States that are Q card carrying members are not defined by reference to a common employer, affiliated employers, coverage under a collective bargaining agreement, or membership in a labor union. Additionally, there is no evidence that the eligible employers are engaged in the same line of business in the same geographic locale.

Applicant's Position

You represent that the educational component of your program qualifies for exemption under IRC§501(c)(3). You believe that consumers need help understanding how to obtain affordable healthcare coverage and understanding the new health care laws in the PPACA. You also provide healthcare management functions that help employers and employees that do not have the expertise to manage their own healthcare plans.

You stated that "The employers that participate in the VEBA Trust will no longer have a need for employees to manage health insurance benefits and or adjudication issues arising from insurance company errors."

The VEBA program is an integral part of your educational programs as well as your management functions. You "are in the healthcare business and the healthcare management business." You "are not in the commercial insurance business and will not market as such." You stated that you are structured similar to "Private Health Insurance Exchanges" and compared yourself to two private exchanges that are owned by for-profit insurance companies.

You represent that an employment-related bond exists because affiliated companies participate in your VEBA trust. You also have a geographic locale of the United States and are willing to change to any other geographic locale.

You also claim there are no definitions of affiliated companies and you refer to IRC sections 414(b)(c) and (m). "That a management-type affiliated group exists when an organization performs management functions, and the management organization's principal business is performing management functions on a regular and continuing basis for a recipient organization."

"There does not need to be any common ownership between the management organization and the organization for which it provides service." "Any person related to the organization performing the management function is also to be included in the group that is to be treated as a single employer."

Service Response to Applicant's Position

You failed to provide any additional information from which it can be concluded that you qualify under sections 501(c)(3) or 501(c)(9) of the Code. Your purposes to institute VEBA participation and operate similar to a private health insurance exchange do not meet the organizational or operational tests for exemption under section 501(c)(3). In addition, you are not an association of employees as required under Section 501(c)(9).

Your references to IRC code section 414 which provides definitions and special rules for employee benefit plans is not relevant because this code section does not cover exemption requirements under sections 501(c)(3) or 501(c)(9). Additionally, your VEBA program does not demonstrate there is an employer-related common

bond as required by the regulations. As in Harding Hospital, supra, you have the burden of proving that you satisfy the requirements for tax exemption. You have failed to provide enough information to prove to us that members share an employment-related common bond or that you are not operating in a non-exempt manner.

Applicant's Protest

You wrote you are organized for educational purposes; you are operating exclusively for that purpose in the healthcare market.

With regard to Section 1.501(c)(3)-1(b)(1)(i), you stated your Articles of Incorporation limit you to one exempt purpose of educating the consumer to be able to obtain affordable healthcare. The formation of a 501(c)(3) is also part of that one exempt purpose because it reconnects the purchaser and user of healthcare. You also wrote that your experience has proven that the learning curve is accelerated and that the consumer with the right support becomes a more thoughtful consumer of healthcare. You believe that this satisfies the requirements of your tax exempt status request. You also state you have no underlying commercial motive as we have implied in the citation of Better Business Bureau.

With regard to our citation of est of Hawaii, you wrote that you have a total of twelve programs/services offered to your members and only one is contracted out for management. You also indicated that the core competencies within the retained eleven educational programs are provided by employees of yours and your rights to use the Q card are for 50 years. Furthermore, you stated that R has no control over you and can be replaced with a different card located in U. You also indicated that you were unaware of this company in your previous correspondence because you just learned of their capabilities.

You contend the citation to Easter House is not on point as you have no for profit or not for profit competition with your current structure. The citation to Arlie Foundation v Commissioner applying the commerciality document you believe is also not on point. Though you indicated you have no direct competition at the moment, the closest concept to your organization is V. You indicated your fee is 38% less than V's and your financial reserves are less than x dollars. You have only an informational website and the Co-op structure is to promote charitable donations and participation in your programs. You also wrote you have no sales and advertising line items. You state that you meet the following factors evidencing the absence of a commercial purpose:

- Lack of competition with for profit entities
- Below market rate pricing
- Relatively insubstantial reserves
- Lack of commercial advertising practices
- The absence of sales to the general public
- Low volume of sales
- Use of volunteers and low paid professional staff
- Significant charitable contributions

501(c)(9)

You indicated your offering of a VEBA trust is a structure that reconnects healthcare purchaser and user. It is also a tax exempt structure that supports the 501(c)(3) exclusively for charitable and educational

purposes. What is important here you indicted is the motivation of the participants to engage in their health care decisions.

You further stated that you meet Section 1.501 (c)(9)-2(a)(1) of the regulations because your membership consists of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute a common employment related bond. You also indicted that this is evidenced by the employers' and employees' participation in you creating a common bond focused on educational services about health care.

You also stated that you meet Section 1.501(c)(9)-2(a)(2) of the Regulations because there are objective conditions related to employment as both employers and employees are your participants.

Your conclusion states you disagree with the application of the 501(c)(3) law because you claim you are exclusively organized and operated for charitable and educational purposes. Beyond your specific services to members, you wrote that you lessen the burdens of government and offer promotion of social welfare. As one example you cited, the PPACA has a major impact on tax payer's dollars that would be lessened by your efforts. You believe through your structure that local communities can take care of their own and that offering a VEBA program is an enumerated educational exempt purpose. Moreover you stated this structure is being used by the PPACA and represents a community learning center.

You disagree with our application of the 501(c)(9) law because you believe you meet an employment related common bond of affiliated companies among employees whom voluntarily participate in the VEBA program. This is supported by a formal legal promise structured by the trust financial document of both participating employers and participating employees. Finally, you indicated that IRC code 414 is relevant as it sets precedent to this type of organizational structure and you stated you have met the requirements of tax exempt status.

Our Response to Applicant's Protest

You failed to provide any additional information from which it can be concluded that your activities exclusively further or advance a purpose described in Section 501(c)(3) or that you are primarily operating for 501(c)(9) purposes. You fail the organizational test as previously analyzed. You are also operating for substantial nonexempt purposes. For instance, you are operating for commercial purposes as demonstrated in the manner in which you are providing the health care insurance to unrelated businesses. You even stated you are structured similar to Private Health Insurance Exchanges that are owned by for-profit insurance companies. You are also providing commercial like services through R to your members.

You are also operating for substantial private purposes. For example, you purport the contract with R is only one of your activities and there is another entity that could provide the same services. This does not change the fact that you are operating for the benefit of R. In addition, the majority of your resources are devoted to the provision of specific health care services and this is being contracted to R as well as the fact that most of your revenue is being paid to R.

Although you may have educational components that may qualify under Section 501(c)(3), the presence of non-exempt commercial purposes of the provision of health insurance and the presence of the private purposes of operating the VEBA for unrelated employers/employees and for the private benefit of R precludes exemption under section 501(c)(3).

You also wrote you believe you are lessening the burdens of government. Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations defines the term “charitable” as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term “charitable” also includes the lessening of the burdens of government.

Revenue Ruling 85-2, 1985-1 C.B. 178 considered whether an organization providing legal advice and training to volunteer guardians *ad litem* for abused children qualified under section 501(c)(3). The ruling states that a determination whether an organization is lessening the burdens of government requires consideration of whether the organization's activities are activities that a governmental unit considers to be its burden, and whether such activities actually lessen such governmental burden. To determine whether an activity is a burden of government requires an objective manifestation by the government it considers such activity its burden. The fact that an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government. Similarly, the fact that the government or an official of the government expresses approval of an organization and its activities is also not sufficient to establish that the organization is lessening the burdens of government. The interrelationship between the organization and the government may provide evidence that the government considers the organization's activities to be its burden.

You have not provided information that you meet Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations. As noted in Revenue Ruling 85-2, the fact that an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government. Moreover, there is no interrelationship between you and the government which also substantiates you are not lessening the burdens with the meaning of Section 501(c)(3). Finally, the mere fact that a governmental agency has a policy or program to promote a certain outcome does not mean that the government has assumed the burden of engaging in that activity.

Additionally, your VEBA program as previously discussed does not demonstrate there is an employer-related common bond as required by the regulations. Therefore, you are not operating in accordance with 501(c)(9).

Conclusion

Based on the facts presented above, you failed both the organizational test and the operational test required of 501(c)(3) organizations.

You have not demonstrated employment-related common bond as required under section 1.501(c)(9)-2(a)(1) of the regulations. Therefore, you do not qualify for exemption under section 501(c)(9).

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents

- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

For authorized representatives:

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

Where to send your protest

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Jeffrey I. Cooper
Director, Exempt Organizations
Rulings and Agreements

Enclosure:
Publication 892